مؤسسة محمد بن راشد لتنمية
المشاريع الصغيرة والمتوسطة
DUBAI SME

An Agency of the Department of Economic Development – Government of Dubai

SMEs Business Optimism Survey

Q3 - 2013

AT A GLANCE

- The composite Business Confidence Index for the SME sector in Q3, 2013 reached 127.2 points, 2.5 points higher than in the same period last year, indicating that the outlook for the coming quarter (Q3, 2013) is buoyant and strong.
- The overall prospects for sales are very upbeat, with 95% of businesses expecting either an increase or no change in the volume of sales in the next quarter.
- Overall, 65% of the companies in the sample reported no hindrances to their business operations this quarter (vs. 22% in Q2, 2013), which is a sizable proportion in view of the many business environment constraints that they may face.
- Competition is the leading business challenge for 17% of the SMEs, while 4% are concerned about the slowing demand for products/services.
- The survey also reveals that although they hold a positive outlook, SMEs are less confident than large companies on sales volumes, net profits and employment.
- SMEs are less inclined to invest in capacity expansion in the next 12 months as well as invest in technology upgrade compared to large companies.

The Department of Economic Development (DED) is a Dubai Government Department that has the mandate to help achieve the key strategic objectives of fostering ‘Sustainable Economic Development’ and strengthening the ‘Competitiveness of Dubai’.

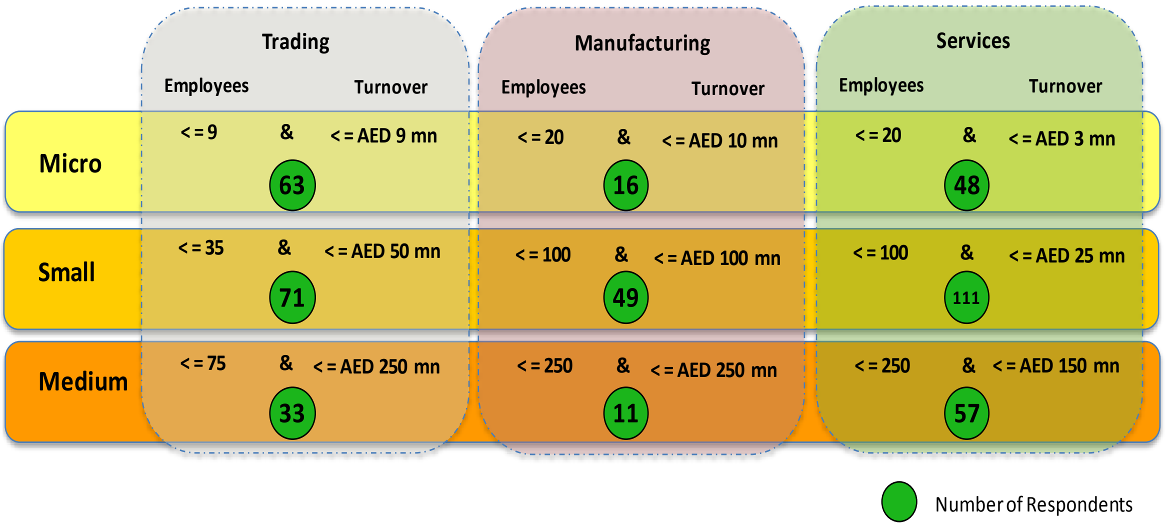
In order to gauge the perceptions of the business community, DED conducts the Dubai’s Quarterly Business Survey, which provides a snapshot of Dubai’s current economic activity and the outlook for the quarter ahead.

This document presents a summary of the survey conducted in the 3rd Quarter of 2013 and highlights the future expectations of SME businesses in Dubai. The survey was administered to 459 SME businesses in Dubai. In addition, the survey addresses challenges that may impact business growth and development and assesses the investment outlook for the coming twelve months.

METHODOLOGY

The quarterly business survey for Q3, 2013[1] was conducted for a total of 508 companies across the Emirate of Dubai. The sample included a mix of small, medium and large enterprises and ensured an adequate representation from the Manufacturing, Trading and Services sectors, in the same proportions as their respective contributions to Dubai GDP.

Figure 1: Distribution of SME respondents across industry groups



From the perspective of tapping 'business outlook' or expectations, the survey focused on key indicators, such as *sales, selling prices, volumes sold, profits and No. of employees.* Respondents were asked to indicate if they expect an 'increase', 'decrease' or 'no change' in these indicators.

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[1] *For the purpose of the survey, each quarter is defined as follows: Q1 is the period between January and March, Q2 is the period between April and June, Q3 is the period between July and September, and Q4 is the period between October and December of each year.*

SME Business Confidence Index Calculations

The SME Business Confidence Index (BCI) is calculated as a weighted average score of the following ‘business outlook’ indicators:

- Selling Prices
- Volumes Sold
- Number of Employees
- Profits

For each indicator, ‘Resultant scores’ are calculated using the net balances method: (% of positive responses - % of negative responses) + 100

For calculating the SME Composite Business Confidence Index for Dubai, the resultant scores are multiplied with their corresponding parameter weights to arrive at a weighted average Index score. The SME composite index score is finally rebased so that Q2, 2011 = 100.

BCI scores are classified in the following three groups:

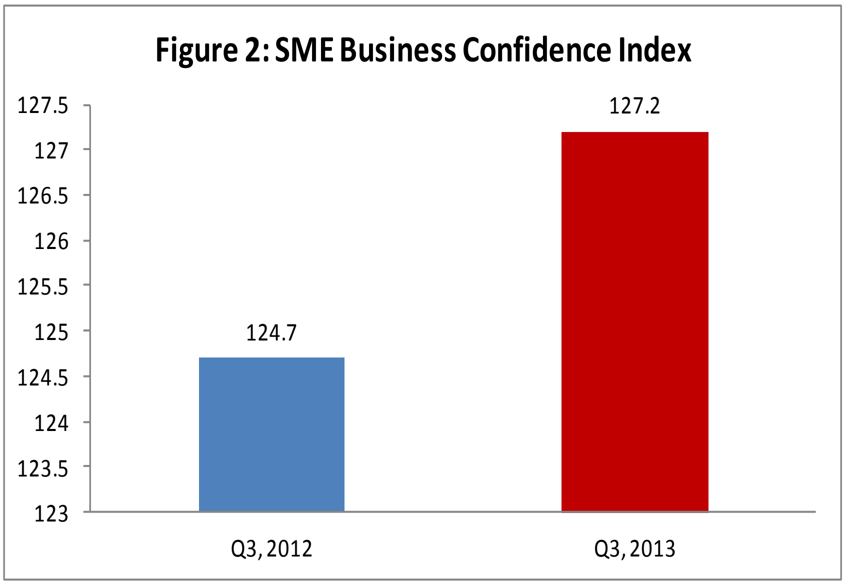
- ***BCI < 100, business expectations are negative***
- ***BCI = 100, business expectations are stable***
- ***BCI > 100, business expectations are positive***

When expressed with reference to the base quarter Q2-2011, the following interpretations hold (t and t-1 referring to two consecutive quarters:

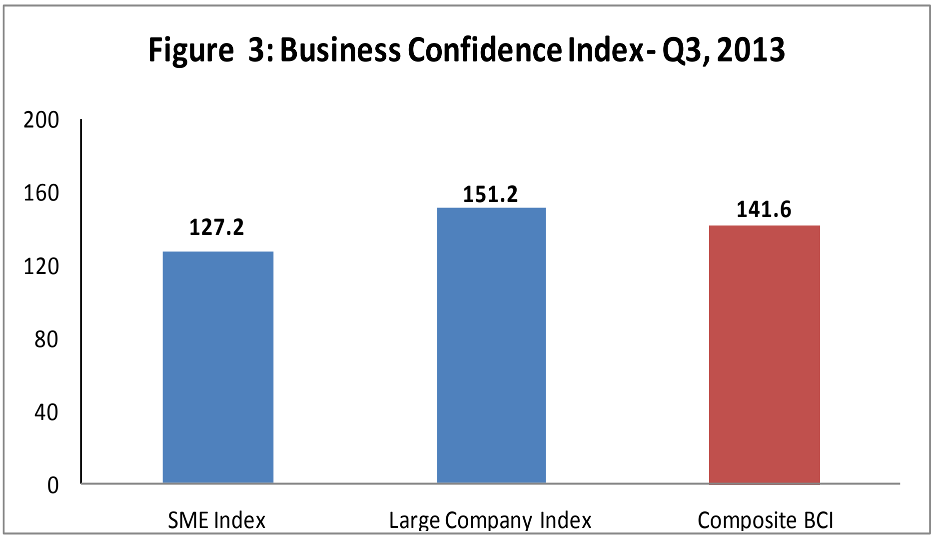
- ***BCI(t)< BCI(t-1): business expectations are declining***
- ***BCI(t) =BCI(t-1): business expectations are stable***
- ***BCI(t)> BCI(t-1): business expectations are rising***

SME BUSINESS CONFIDENCE INDEX – Q3, 2013

A broadening recovery in construction and real estate, and ongoing growth in tourism and other non-hydrocarbon sectors are underpinning non-oil growth in Dubai. Non-oil exports increased 22% from H1 2012 to AED 84 bn in H1 2013, reflecting Dubai's steady recovery. This robust growth is reflected in the Q3, 2013 business survey, which shows a strong business confidence index reading of 127.2 for Dubai's SMEs.



A year-on-year comparison reveals an increase of 2.5 points over the index value during the same period in 2012. Quarter-on-quarter comparison shows that the current quarter composite index is 14.5% higher than the index in the previous quarter due to business expectations of rising demand as well as the cyclical uptrend in economic activity during the fourth quarter of the year on account of the festival season and larger inflow of tourists during winter. For Q3 2013, there is a rise in optimism levels for selling prices and employment compared to the levels observed in Q3, 2012, while all parameters are up compared to the previous quarter.

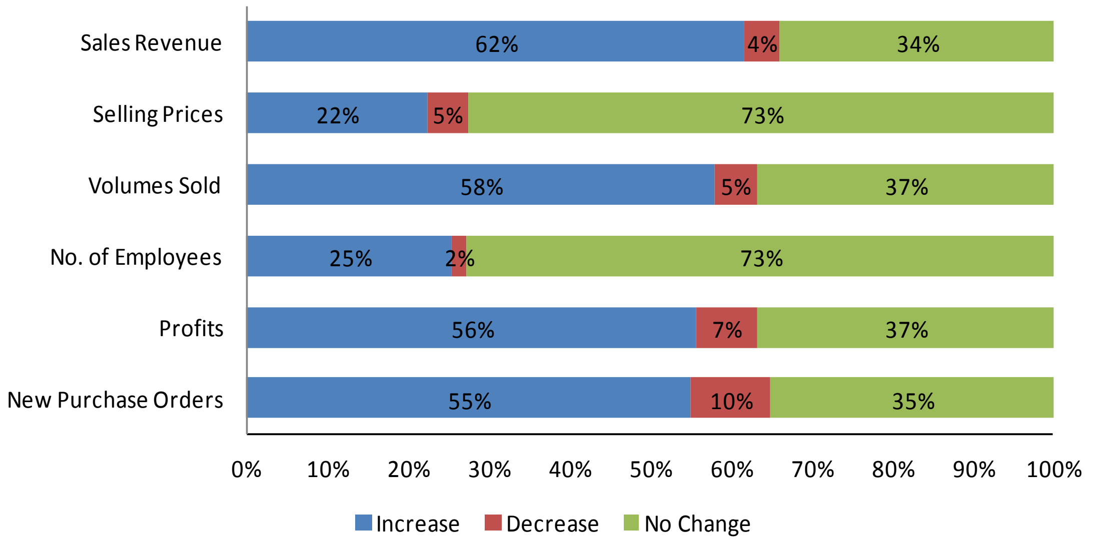


Continuing the trend in the previous quarter, large companies are observed to be outperforming the SME community. The higher confidence among large companies is due to their very optimistic outlook with respect to volumes sold, hiring and profits as reflected in their index value of 151.2 compared to 127.2 for SMEs.

SME BUSINESS OUTLOOK – Q3, 2013

Given the dominant share of SMEs in Dubai's total business composition (95% of the total number of firms), 459 of the 508 respondents who were interviewed as part of the survey were SMEs. These included micro, small and medium enterprises as per Dubai's SME definition. The survey reveals that although SMEs hold a strong outlook for the fourth quarter, they continue to be less confident than large companies on all parameters constituting the index.

Figure 4: Forecast Business Performance (SME) - Q4, 2013



SMEs echo the overall business sentiments with the survey showing positive expectations for the upcoming quarter, as 62% of the respondents expect an increase in and 34% report no change in sales revenues for Q4, 2013. A year-on-year comparison reveals that net balances for sales revenues have remained almost steady, standing at positive 58% in Q4 2013 versus positive 61% in Q4 2012.

Increase in real business activity (volumes) as well a rise in selling prices will drive the rise in sales revenues. A year-on-year comparison shows a moderation in net balances for volumes sold and growth in business activity, with a decline from positive 61% in Q4, 2012 to a positive 53% in Q4, 2013. Q-o-q comparison shows an improvement from positive 25% in Q3 2013 to 53% in Q4, 2013.

A comparison between SMEs and large companies shows a continuation of trend from the last quarter for sales revenues, with SMEs demonstrating lower optimism in Q4, 2013, indicated by a positive net balance equal to 58% against 88% for large companies. The higher optimism in large companies is driven by a more optimistic outlook with respect to sales volumes (86% of large companies vs. 58% of SMEs are expecting an increase in Q4, 2013).

Business sentiments are driven by upbeat expectations across all key sectors. However, the services and manufacturing sectors are more optimistic with respect to sales volume, profitability and hiring, while selling prices optimism is highest among service sector companies. For this quarter, expectations for volumes sold among large companies are very high, with not a single firm expecting a decline in volumes for the fourth quarter.

Manufacturing and service sectors have higher expectations in terms of expected sales volumes for Q4, 2013 compared to trading firms (positive net balance of 56% for manufacturing SMEs, 57% for services SMEs and 46% for trading SMEs).

Manufacturing Sector:

A year-on-year comparison for the manufacturing sector outlook reveals a moderation in net balances for sales volume, declining from positive 72% in Q4, 2012 to 56% in Q4, 2013, although the latter still indicates a relatively strong positive outlook. A quarter-on-quarter comparison shows a sharp gain in the manufacturing sector’s outlook, with the net balances increasing from positive 26% in Q3, 2013 to positive 56% in Q4, 2013. This is due to the cyclical uptrend in economic activity during the fourth quarter of the year on account of the festival season and larger inflow of tourists during winter.

Within the manufacturing sector, firms engaged in the manufacture of chemicals, cement and glass reflect a higher optimism compared to the other sub-sectors. A majority of the businesses that are expecting an increase in volumes are hopeful of getting new contracts or orders during the coming quarter. Manufacturers of furniture and food & beverages are also upbeat with respect to the sales outlook during Q4 2013. 61% of the respondents from the manufacturing sector expect their volumes to increase, while 34% anticipate no change and 5% foresee a decrease.

Services Sector:

For the services sector, year-on-year comparison reveals moderation in outlook for volumes sold (positive net balance of 57% for Q4, 2013 versus positive 66% for Q4, 2012). However, the outlook for the overall service sector has become much more optimistic in Q4, 2013, compared to the previous quarter (positive net balance of 25% in Q3 2013). Within this sector, sales volumes expectations are higher for companies engaged real estate, business services, ICT, car rental firms and restaurants & hotels with the key reason cited as expectations of higher demand levels.

Companies in the architecture and construction sectors are expecting new projects/contracts in the local as well as regional markets, which would lead to an increase in their overall business activity. Nearly 57% of transportation providers are hopeful of an increase in their contract volumes in the coming quarter.

Hotels and restaurants are very optimistic on their business performance in the next quarter due to the winter season when tourist inflow increases. Around 64% of the respondents in this sub-sector expect an increase in volumes, while the remaining does not anticipate any change. None of the respondents in this sub-sector expects a decline in volumes in the fourth quarter.

Trading Sector:

The survey also indicates that optimism in the trading sector is similar to that for Q4, 2012, with a net positive overall balance of 46% (50% last year), which is the result of 55% of the respondents anticipating an increase in volumes and 9% predicting a decline.

Key sub-sectors hopeful of an increase in demand over the next quarter include:

- In line with confidence expressed by construction sector firms, traders in the building material sub-sector have positive expectations on sales volumes as the former expect to get new projects (64% expect an increase)
- 69% of the traders in the electronics sub-sector foresee higher volumes in Q4, 2013, citing new orders/projects or because they expect to increase exports
- 75% of pharmacies are upbeat about the fourth quarter as they expect more demand

Selling prices are expected to remain stable in the coming quarter as well, with 73% of the companies expecting no change in the selling prices of their products or services, similar to the level in the previous quarter (79%). However, the selling price outlook for Q4, 2013 is much stronger than that in the same quarter a year ago (net balance of positive 17% this year versus 3% last year). 22% of the SMEs intend to increase their prices, in order to compensate for increased raw materials or operating costs or because they can increase prices as they expect higher demand for their products/services. Services SMEs (net balance of positive 21%) are more optimistic than the manufacturing SMEs (net balance of positive 15%) as well as trading SMEs (net balance of positive 8%) with respect to their selling prices.

Consistent with positive expectations on sales, 55% of businesses are also planning to increase their new purchase orders in the next quarter, hopeful of acquiring new projects, coupled with rising demand typically expected during the winter season. Nearly 35% of businesses that are planning to maintain the same level of purchase orders stated that they had already made their purchases in the previous quarters and were currently holding sufficient stocks. Respondents in the manufacturing sector are slightly more optimistic compared to the trading and service sector companies with respect to their new purchase order activity: 58% of manufacturing firms versus 54% each in trading and services expect to increase their new purchase orders in Q4, 2013. SMEs hold a less optimistic outlook than large companies on new purchase orders with 55% of SMEs compared to 78% of large companies expecting an increase in the next quarter.

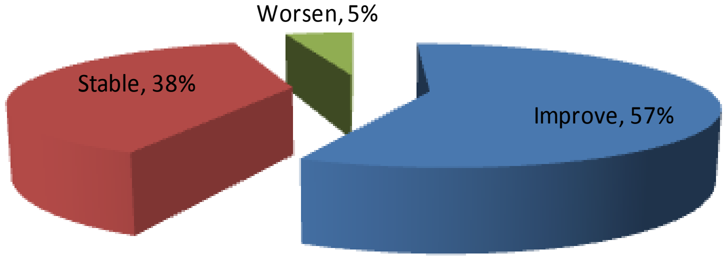
The y-o-y outlook for hiring has improved for Q4, 2013, with 25% of the businesses expecting to increase their employee count compared to 7% in Q4, 2012. Key differences across sectors are as follows: Manufacturing and service firms are more optimistic about hiring compared to trading firms, with 33%, 31% and 15% planning new hires respectively. The survey also reveals that a marginal 2% of businesses expect to reduce their workforce in the next quarter, the same proportion as in the previous quarter. Following the trend in the previous quarter, SMEs are less optimistic than large companies with respect to hiring (net balance of positive 35% for large companies compared to 23% for SMEs).

With respect to capacity utilization, SMEs are less optimistic than large companies, following the trend in the previous quarter (net balance of positive 48% for SMEs versus a net balance of positive 82% for large companies).

Profitability expectations are in line with the overall sales expectations, with 56% of the respondents expecting an increase in net profits on the back of winning new contracts with better margins. Sectoral comparison shows that all manufacturing and service sectors have optimism levels on profitability compared to trading firms (58% of manufacturing, 59% of services and 50% of trading firms reporting an increase in Q4, 2013). Profitability outlook has moderates y-o-y for SMEs, with a net balance of positive 49% for Q4, 2013 versus 61% for Q4, 2012. Finally, following last quarter’s trend, SMEs remain less optimistic than large companies about profits, with a net positive balance of 49% for SMEs against 74% for large companies.

According to the firms' overall assessment, the business outlook for Q4, 2013 has improved, with 57% of the respondents reporting an improvement in business conditions (37% in Q3, 2013), 38% expecting stability and a marginal 5% anticipating deterioration.

Figure 5: Expected Business Situation (SMEs) - Q4, 2013



Furthermore, a comparison between large companies and SMEs shows that the former are more optimistic, with 57% hopeful of an improvement in Q4, 2013, against 71% of the SMEs. Some of companies that expect the business environment to worsen have mentioned high competition and lack of demand as the key reasons.

SME PERFORMANCE – Q3, 2013

Although the main purpose of the survey is to gauge business expectations for future activity, it also tries to capture the actual changes in business performance of SMEs from one quarter to another, as reported qualitatively by responding firms.

Business activity in Q3, 2013 was stronger compared to the previous quarter as a higher number of respondents reported an increase rather than a decrease in sales volumes (net balance of positive 13%, which is higher than the positive 6% reported in Q2, 2013). All sectors reported a positive performance with respect to volumes sold in Q3, 2013, with a net balance of positive 11% in manufacturing (compared to positive 17% in Q2, 2013), positive 7% in trading (compared to positive 1% in Q2, 2013), positive 15% in construction, positive 23% in transportation, positive 18% in tourism & hospitality and positive 18% in the overall services sector. In addition, large companies reported a much better business performance in the current quarter with a positive net balance of 45% compared to 13% for SMEs.

- In the manufacturing sector, the sub-sectors that showed positive activity were cement, food and beverage, metals and printing. However, firms dealing in furniture and garments manufacturing faced a slowdown in activity, possibly due to increased competition, retraction in projects and reduced consumer demand.
- The positive performance of the trading sector in Q3, 2013 was due to an increase in activity in the following sub-sectors: general traders, computers (new projects), cosmetics (new outlets), electronics (new projects and customers), garments (festival) and jewelry.
- The encouraging performance of services in Q3, 2013 was led by an increase in activity in the following sub-sectors: construction (more projects), real estate (recovery in the real estate rental and buying market), tourism & hospitality and transport (new markets, higher exports).

Once again selling prices remained largely stable, with 68% of the respondents reporting 'no change' in Q3 2013 against 14% who reported a decline due to low demand and competition.

Workforce numbers improved during Q3, 2013, with 20% of the businesses reporting an increase in their workforce during the quarter, higher than the 5% reporting an increase in Q3, 2012. However, a majority of the firms (70%) reported stability in their employee count for this quarter. Services and manufacturing experienced larger increases, 7% and 9% respectively compared to 2% in the trading sector. Also, a higher proportion of large companies (39%) compared to SMEs (20%) reported an increase in their employee count.

Consistent with the overall performance of the business community on sales volumes, new purchase orders also increased during Q3, 2013, as reflected in a positive net balance of 18%, higher than the negative 5% in Q3, 2012 and the positive 11% in Q2 2013. All key sectors reported an improvement in new purchase orders during the second quarter, with manufacturing reporting a net positive balance of 12%, trading 13% and services 25%. As in the previous quarter, large companies reported a much better performance on new purchase orders as reflected by the positive net balance of 51% in Q3, 2013.

The unit cost of labor remained stable for the majority (65%) of firms in Q3, 2013. However, 33% reported increases, traced back to the following reasons: revision of salaries, granting increments, higher labor accommodation rent as well as increase in cost of living, and recruitment of new staff at higher salaries. In Q3, 2012, just 11% of the SMEs reported an increase in labor costs. In the case of large firms, 39% reported an increase in labor costs in Q3, 2013.

The cost of raw materials increased for 34% of the respondents, which is similar to the 32% reported in Q3, 2012. This rise impacted manufacturing firms the most as in the previous quarter, with 46% indicating an increase in Q3, 2013 against 31% each for trading and services. The impact of such costs affected 43% of large companies in Q3, 2013.

Rental costs remained mostly stable in Q3, 2013 according to 97% of the respondents and increased for the remaining 3%. In Q3, 2012 rental costs increased for 7% of the responding firms. The impact of rental costs increases was slightly higher for manufacturing and service sector companies, 4% each, compared to 1% for trading SMEs. With respect to large companies, 8% reported an increase in rental costs in Q3, 2013.

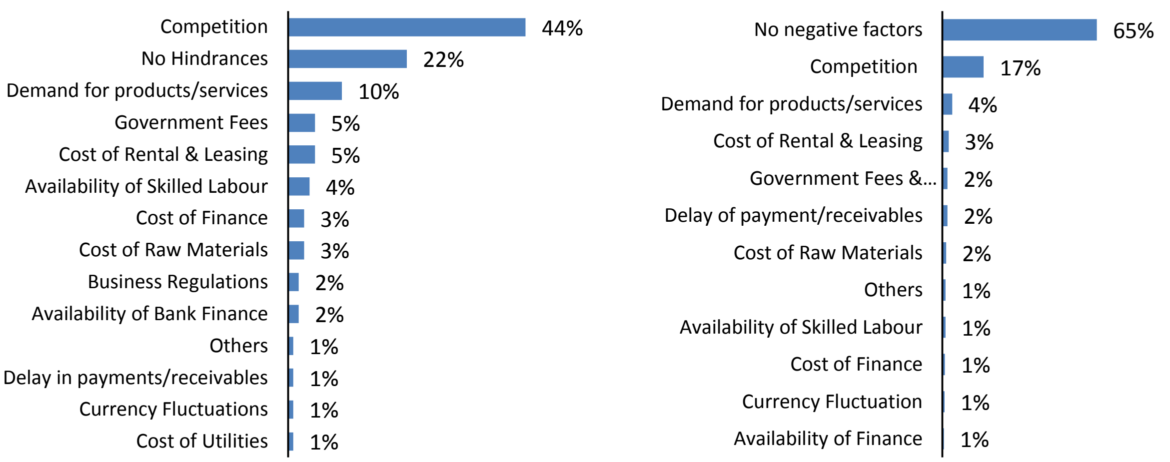
The current quarter survey also revealed that around 33% of the respondents were making use of bank finance out of which 66% reported no changes in the cost of finance while 23% reported an increase. The top reasons cited by respondents for not needing bank finance were: sufficient funds, owners do not like taking loans or there is no requirement for funds. Among the large companies, 42% availed of bank finance, of which 48% reported no change in costs, while 29% reported an increase.

The survey also revealed that 30% of respondents reported an increase in their profit levels during Q3, 2013, while 28% reported a decrease. The manufacturing and trading sectors reported a net balance of negative 3% and negative 4% respectively, while the balance was positive 9% for service firms. Following the trend in the last quarter, large companies have reported a better performance on profits in Q3, 2013 compared to SMEs with 47% of the respondents indicating an increase in business profits (net balance of positive 18%).

KEY BUSINESS CHALLENGES IN DUBAI

The survey also addressed key challenges perceived by businesses at the end of Q3, 2013 that may impact business growth and development. Almost two-thirds of the companies (65%) in the sample reported no hindrances to their business operations this quarter (versus 22% in Q2, 2013).

Figure 6: Key SME Business Challenges – Q2, 2013 vs. Q3, 2013



A comparison with the last quarter reveals that the top two challenges in Q3, 2013 are the same as in Q1, 2013, which are, competition and slow demand for products/services.

The following are found to be the major challenges impacting SMEs in Dubai:

1. Competition *(cited by 17% of the respondents):* Competition from local and international players is the top most challenge facing Dubai businesses. In the previous quarter, 44% of the businesses mentioned competition as a leading challenge. Also, 56% of the respondents that cited competition as a challenge stated that the severity of this challenge has increased in the current quarter.

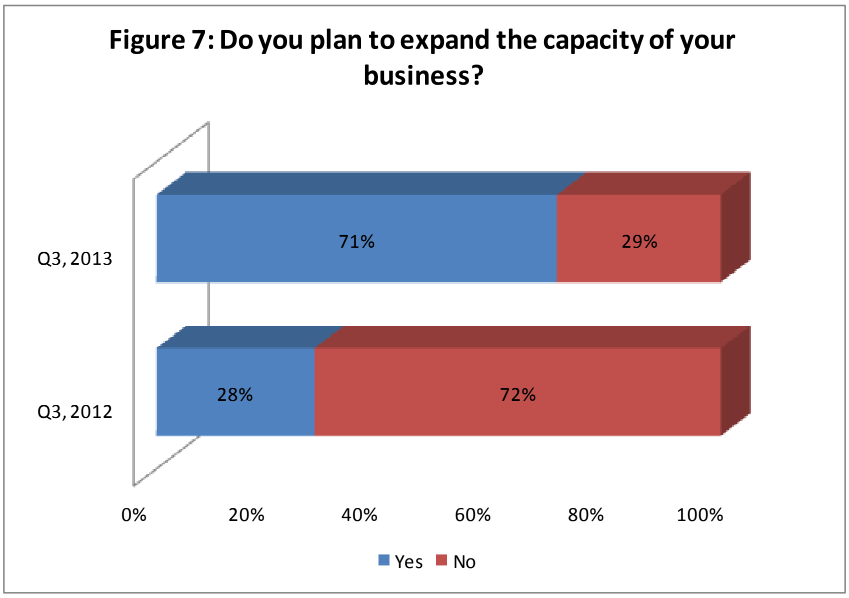
2. Lack of demand for products/services *(cited by 4% of the respondents):* This challenge remains the second most important factor impacting businesses during Q3, 2013. Approximately 37% of businesses that have reported lack of demand as a challenge have said that its severity has increased during Q3, 2013.
3. High cost of rentals & leasing (*cited by 3% of the respondents*): This was reported as a key challenge by businesses that had to renew their leases at higher rentals. Costs of rental and leasing increased for 67% of the respondents citing it as a challenge
4. Government fees (*cited by 2% of the respondents):* This has been reported as the fourth most serious challenge in Q3, 2013 (third in Q2, 2013). The main reasons cited are high costs of trade license renewal and visa fees.
5. Delay of payments/receivables *(cited by 2% of the respondents):* This factor has emerged as an important challenge during the third quarter, and now takes fifth place. 20% of the respondents citing it as a challenge have reported that its intensity has increased during Q3, 2013.
6. Cost of raw materials (*cited by 2% of the respondents*): Among the respondents that cited this factor as a challenge, 86% of them stated that the severity of this factor had increased in Q3, 2013.

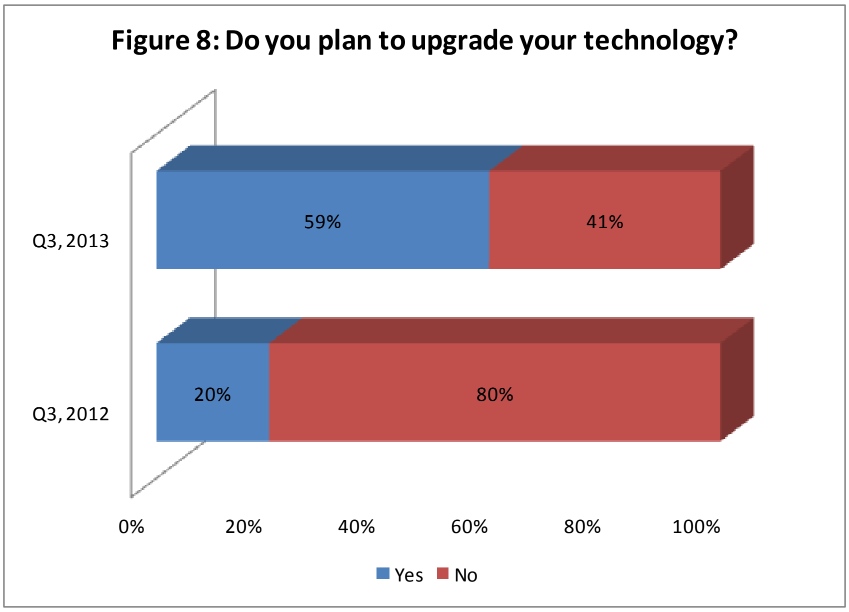
In terms of factors affecting businesses by firm size, for both SMEs and large companies, the top three challenges are competition, demand for products/services, and high cost of rentals/leasing, in the same order.

As for exporters, the top two challenges are also competition and slow demand for products/services.

INVESTMENT OUTLOOK

The survey also gauges the business community's investment outlook with respect to capacity expansion and technology upgrade plans over the coming twelve-month horizon.





On account of the improvement in overall business optimism for the next quarter, the outlook of businesses for future expansion has also improved significantly compared to the same period last year. 71% of the surveyed businesses intend to invest in expansion in Q3, 2013 compared to 28% in Q3, 2012. A q-o-q comparison shows similar expansion plans (71% in Q3, 2013 against 74% in Q2, 2013).

Similarly, plans to upgrade technology have intensified compared to last year. This is evidenced by the fact that 59% businesses have reported plans to invest in technology up-grades in this quarter compared to 20% last year in Q3, 2012.

From a business size perspective, large businesses are more inclined to upgrading technology as well as expanding their capacity. With regards to market orientation, export market-oriented businesses have better expectations on upgrading technology and capacity expansion than domestic market-oriented firms.

Companies that are planning for expansion reported new capital investments such as expansion of the current office premises and the acquisition of new assets such as factories, warehouses, machinery, and vehicles.

Businesses with no expansion plans have cited satisfaction with the current scale of their operations and / or are looking to achieve stability and profitability before adding to their capital expenditures.

Sectoral comparison shows that service (75%) companies are more optimistic about investing in capacity expansion compared to manufacturing (67%) and trading firms (66%). With respect to technology upgrade, service (64%) and manufacturing (62%) firms are more inclined compared to trading companies (51%).